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FINAL REPORT FOR RESEARCH ON MERGERS,
CONGLOMERATES, AND DIVERSIFICATION

by

Arnoldo C. Hax

Technical Report No. 9

Work Performed Under

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Mergers, Conglomerates, and Diversification

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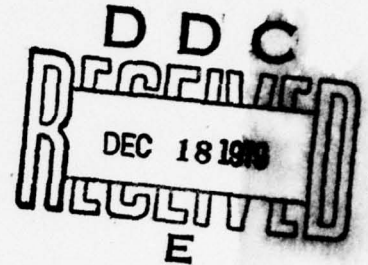
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20. ABSTRACT (Continue on reverse side if necessary and identify by block number) This report presents a Final Report on our research effort on Mergers, Conglomerates, and Diversification. The objectives of this effort were to create a better framework for the study of mergers and diversification; to summarize relevant information; to better understand conglomerates' organization and business strategy; and to build models to predict merger activity and the types of firms most likely to merge. The objectives and accomplishments of the study are listed.		

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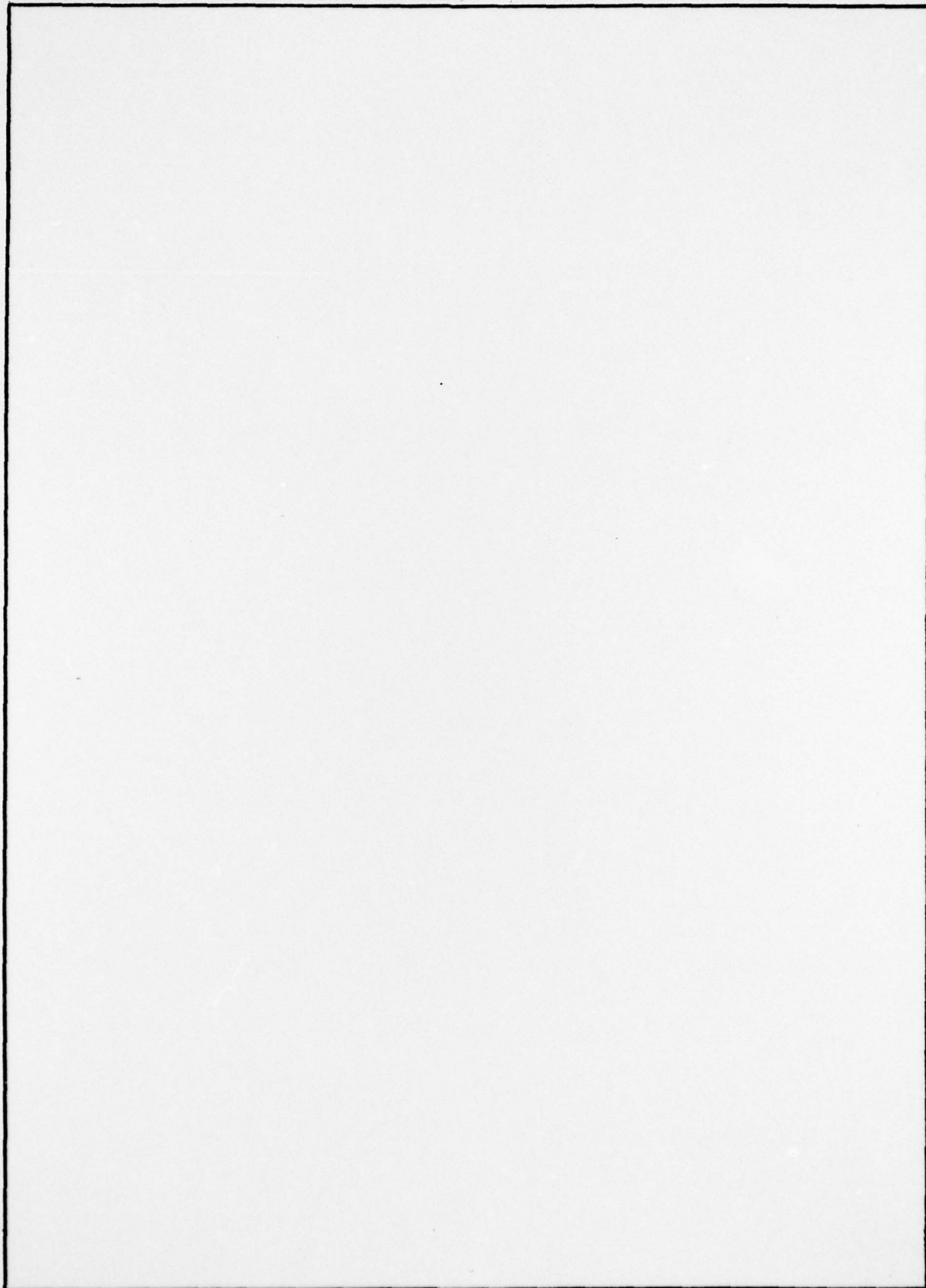
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FINAL REPORT for Research on Mergers, Conglomerates, and Diversification.

Contract N00014-76-C-1033, M.I.T. OSP 84297

Period covered: July 1, 1976 - March 31, 1979.

Principal Investigators: Arnolfo C. Hax and Stewart C. Myers

Objectives of the Research Effort

Since World War II we have seen a full cycle of merger activity and perhaps, in 1977, the start of another cycle. At the same time the number and importance of large, diversified firms have drastically increased. Much of these firms' growth has been by merger. In particular, today's conglomerates are a product of the merger boom in the 1960's.

Our interest in the subject of Mergers, Conglomerates, and Diversification was raised by a request from the Office of Naval Research for us to sponsor a Workshop on the Conglomerate Firm. The Workshop was going to serve as a forum for practicing managers and academicians to exchange ideas on the subject of conglomeration in general, and its impact on the shipbuilding industry.

After the Workshop took place, we requested, and were granted, a continuation of our research effort on Mergers, Conglomerates, and Diversification. The objectives of this effort were (1) to create a better framework for the study of mergers and diversification, (2) to collect and summarize relevant information on this subject, (3) to develop a better understanding of conglomerates' organization and business strategy, and (4) to build models predicting merger activity and the types of firms most likely to merge.

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Accomplishments

a) Workshop on the Conglomerate Firm.

The first phase of the program led to a two-day Workshop on the Conglomerate Firm, held at M.I.T. on October 6 and 7, 1977. The following papers were presented at the Workshop:

- (1) "What We Know and Don't Know About Mergers and Diversification", Stewart C. Myers, Professor of Finance, MIT.
- (2) "Reflective Thoughts on Conglomerate Structure", Phillip H. Smith, Chairman and President, Copperweld Corporation.
- (3) "The Conglomerate Phenomenon: An Overview", Edward M. Graham, Assistant Professor of Management, MIT.
- (4) "Return on Investment and Internal Growth: Basic Objectives of a Multimarket Company", Robert S. Ames, Senior Vice President - Operations, Textron, Inc.
- (5) "Conglomerates in the Shipbuilding Industry: Impact on Corporate Strategy", Henry S. Marcus, Associate Professor of Marine Systems, MIT.
- (6) "A Methodological Approach for the Development of Strategic Planning in Diversified Corporations", Arnoldo C. Hax, Professor of Management Science, MIT and Nicolas S. Majluf, Research Assistant, MIT.
- (7) "The Shipbuilding Company in a Multi-Divisional Corporate Environment", P. Takis Vekiotis, President and General Manager, Quincy Shipbuilding Division, General Dynamics Corporation.
- (8) "Administrative Regulation Versus Market Regulation in the Conglomerate Company", Michael E. Porter, Associate Professor, Harvard Business School and Zenon S. Zannetos, Professor of Management, MIT.
- (9) "The Experience of a New England Company in the Fold of a Conglomerate", Nathaniel S. Howe, President, New Britain Machine Division, Litton Industrial Products, Inc.

The Proceedings of the Workshop were published as:

Arnoldo C. Hax and Zenon S. Zannetos (editors), "The Conglomerate Firm", Sloan School of Management, Technical Report #5, M.I.T., June 1978, 260 pp.

These Proceedings were widely distributed and received very favorable comments.

b) Analysis of the Influences of Conglomeration on the U.S. Shipbuilding Industry.

One of the major concerns of the Office of Naval Research in funding this project was to analyze the influence that a wave of conglomerate acquisitions in many shipyards has had on the U.S. shipbuilding industry. Gary L. Kavanagh conducted a comprehensive study on this controversial issue. The study was published as:

Gary L. Kavanagh, "The United States Shipbuilding Industry and Influences of Conglomerates", Sloan School of Management, Technical Report #1, M.I.T., June 1977, 202 pp.

In this study, an analysis of the U.S. shipbuilding industry was presented. The industry's history was reviewed in perspective; the major governmental participants, policies, and programs were identified and discussed; and the character of the industry was analyzed relative to world shipbuilding and relative to its distribution by major shipbuilders, market sector, and types of vessel produced. Next, a discussion of the development of conglomerates in the national economy and, more specifically, within the U.S. shipbuilding industry was offered. Six major areas of conglomerate influence on the shipbuilding industry were investigated: facility expansion and modernization programs, organizational structure, management philosophy and expertise, Navy shipbuilding claims, power and influence, and financial reporting. An extensive examination of the Navy shipbuilding claims issue was presented because of the impact it has had upon the major U.S. shipbuilding industry market sector.

c) Explaining Conglomerate Mergers from a Financial Theory Perspective.

Another important dimension of our research work attempted to seek a satisfactory explanation of merger and conglomeration activity from a financial theory point of view. The major accomplishment in this area is

represented by Nicolas Majluf's Ph.D. dissertation, published as:

Nicolas S. Majluf, "Study on Mergers: A Rationale for Conglomerate Mergers", Sloan School of Management, Technical Report #6, M.I.T., November 1978, 308 pp.

This study was basically concerned with the following issues:

- (1) It looked at mergers from an historical perspective and analyzed the characteristics of three waves in merger activity: those peaking at the turn of the century (1899), the late twenties (1929), and the late sixties (1968).
- (2) It discussed some of the most popular arguments given to explain mergers: acquisition of monopoly power, synergistic effect, taxes and other economic incentives, diversification of risk, empire building motive, and search for promotional and speculative profits.
- (3) It introduced the notion that looking at mergers from a financial point of view may provide a valid platform for analyzing the current expansion of merger movement.
- (4) It proposed a financial equilibrium model that opened the possibility of justifying mergers via tender offers.

We were in the process of validating or disproving the theory presented in this thesis via empirical testing when the Office of Naval Research project was terminated.

d) The Development of Formal Planning Systems for Diversified Corporations.

A final dimension of our work was concentrated in the managerial implications of dealing with diversification by means of formal strategic planning systems in business firms. The following publications represent our contributions in this field.

Arnoldo C. Hax and Nicolas S. Majluf, "Towards the Formalization of Strategic Planning - A Conceptual Approach", Sloan School of Management, Technical Report #2, M.I.T., August 1977, 44 pp.

This was further developed in:

Arnoldo C. Hax and Nicolas S. Majluf, "Towards the Formalization of Strategic Planning - A Conceptual Framework", Sloan School of Management, Technical Report #7, M.I.T., December 1978, 53 pp.,

which will be published in AMS, Vol. 1, No. 1. Also published was:

Arnoldo C. Hax and Nicolas S. Majluf, "A Methodological Approach for the Development of Strategic Planning in Diversified Corporations, Sloan School of Management, Technical Report #3, M.I.T., August 1977, 81 pp.,

which was also published as a chapter in STUDIES IN OPERATIONS MANAGEMENT (A. C. Hax, editor), North Holland, 1978.

Arnoldo C. Hax and Nicolas S. Majluf, "Organization Design", Operations Research Center, Technical Report #163, M.I.T., May 1979, 99 pp.,

will appear as a feature article in the Operations Research journal. An aggregated version of it will appear as a chapter in THE MANAGEMENT HANDBOOK, to be published by John Wiley.

Arnoldo C. Hax and Gerhard Schulmeyer, "Introducing a Formal Strategic Planning System in a Business Firm", Sloan School of Management, Technical Report #8, M.I.T., June 1979, 38 pp.

will also appear in IMPLEMENTING STRATEGIC PLANNING (P. Lorange, editor), to be published by Prentice Hall. A revised version is being considered for publication in Harvard Business Review.

We believe that we have made significant contributions to the conceptualization and methodological development of strategic planning, a subject of foremost importance in the management field.

Concluding Remarks

Thanks to the support provided by the Office of Naval Research, we feel that we were able to establish an important interdisciplinary research activity around the issues of Conglomerates, Mergers, and Diversification. Several members of our faculty contributed to this effort. Among them, we could cite: Edward M. Graham (Assistant Professor of Management), Arnoldo C. Hax (Professor of Management Science), Henry S. Marcus, (Associate Professor of Ocean Engineering), Stewart C. Meyers, (Professor of Management), Edgar H. Schein (Professor of Management), Richard Schmalensee (Associate Professor of Management), and Zenon S. Zannetos (Professor of Management).

We are greatly indebted to the Office of Naval Research for the important support they have provided us.